Update: Prime Backs out of Daughters Hospital Deal Due to California AG's "Onerous" Conditions

Update (March 10, 2015):

Today Prime announced that it would not go forward with its proposed acquisition of six Daughters of Charity hospitals. Prime cited the California Attorney General's onerous conditions as its reason for backing out of the deal. Those conditions, which certainly tested Prime's commitment to the type of acquisition and future plans for the charity hospitals that the AG's office envisioned, are detailed below in our original post on this potential sale. The remaining challenge is for Daughters, whose future is uncertain without a purchaser to turn the charity chain around financially, as discussed in today's news coverage.

Our Original Post:

On February 19, , California Attorney General Kamala Harris approved the controversial sale of six Daughters of Charity Health Facilities to Prime Healthcare. The $843 million deal, the largest ever reviewed by the California AG's office, is described in this press release, and in full here.

The Attorney General's decision was not easy. Robert Issai, Daughters' CEO, stated that if the Attorney General did not approve the deal, he would begin bankruptcy proceedings for the foundering hospitals that had historically provided a substantial amount of charity care for low income and indigent patients. Prime has a history of purchasing financially distressed hospitals and keeping them open. Opponents of the sale argued, however, that Prime had a history of laying off employees and cutting access to less profitable services. Further, Prime has recently faced charges of issuing fraudulent bills to Medicare and Medi-Cal. By approving the sale, Harris opted to keep the hospitals open and serving their charitable mission, while placing substantial conditions on Prime.

The sale represents the latest example of a large hospital consolidation permitted by state authorities. Most recently, the Source covered former Massachusetts AG Martha Coakley's approval of Boston healthcare behemoth's proposed acquisition of another hospital there, which was subsequently recanted by her successor based on concerns about the deal's potential anticompetitive effects.

The Daughters sale was governed by the California Code provisions related to the Attorney General's review of the sale of non-profit corporations to for-profit corporations. Specifically, under Title 11, Section 999.5(f) of the California Corporate Code, the AG must consider the following ten factors in the sale of a non-profit to a for-profit corporation, including whether:

- the terms are fair to the selling non-profit;
- the deal will result in inurement to a private person or entity;
- the deal is for fair market value;
- the fair market value has been manipulated by the parties;
- the use of the sale's proceeds is consistent with the charitable trust held by the non-profit;
- the transaction involves a breach of trust;
- the parties have provided sufficient data to the AG to evaluate the transaction and its effects on the public;

- the transaction' effect on the availability or accessibility of health care services to the affected community;
- the effect of the agreement or transaction may be substantially to lessen competition or tend to create a monopoly|and
- the nonprofit will retain enough independence after the transaction.

After considering the proposed sale under the above conditions, the AG's Office offered approval, subject to 12 key conditions, listed in its press release. Of the 12 conditions, 6 relate to healthcare access, 2 to investment and pension payment|1 to seismic compliance requirements|1 to anti-discrimination, and 1 to debt collection practices. None of those key conditions relates to concerns about the transaction's effects on competition or the potential for rising healthcare prices. Certainly, the conditions ensure that the facilities will continue to provide access to a range of healthcare procedures, Medi-Cal coverage, and charity care|however, they do not address the potential for price increases or increased leverage in contracting that might result from the deal.

The focus on access as opposed to competition in the Daughters sale distinguishes the case from Partners, another recent instance in which a state attorney general has placed significant conditions on the sale of nonprofit hospitals to a larger hospital system. As state attorneys general become more involved in restricting deals that may drive cost or reduce access in their state, careful attention should be paid to their offices' capacities to effectively enforce these conditions and the long term implications of the sales.

Effective enforcement would have been one of the biggest challenges with the consent decree negotiated by former Attorney

General Martha Coakley in Massachusetts. Although the consent decree capped price increases and mandated component contracting to limit anticompetitive effects, those provisions would only have been in place for ten years. After that, Partners could have increased prices at the acquired hospitals to match those of its Boston hospitals. Further, the Massachusetts AG's office would have been responsible for monitoring compliance, which could have given rise to substantial time and resource burdens.

In California, maintaining access to six charity care hospitals and ensuring employee pensions outweighed the potential for profiteering and anticompetitive price increases. In focusing on access, Kamala Harris established conditions that should prove easier to monitor and enforce, like requiring Prime to keep five of the six facilities open for a minimum of ten years, retain the hospitals' certification for Medi-Cal and Medicare for ten years, continue to provide charity care at historic levels, and continue to provide essential health benefits at the facilities. However, by not addressing the potential short and long-term impacts of this sale on the ever-consolidating health care market in California, the sale could lead to substantial price increases for non-indigent patients and a reduction in access at these six hospitals in the future.

Overall, Harris' conditional approval had all the signs of a good compromise – both sides declared victory. Nonetheless, controversy remains as Daughters filed suit against Service Employees International Union-United Healthcare Workers West (SEIU) and private equity firm Blue Wolf Capital Partners for "conspiring to hold hostage" its proposed sale to Prime. The suit, filed in Superior Court in Santa Clara County, alleges that the union and financial firm used "extortionist threats and bid-chilling tactics to frustrate this sale [and] have cost DCHS at a minimum tens of millions of dollars in continuing operational losses and professional fees."

It also remains to be seen whether Prime will accept the deal given the AG’s conditions, which, given their size and scope, will certainly test Prime’s commitment to the purchase. Should Prime decline, Daughters is entitled to a $5 million termination fee. And, if the deal does go through, the jury remains out on the long-term impact on both health care prices and access as a result of this sale.